

Reducing the IR35 pain with a contractor pension

Being caught by [IR35](#) means a significantly increased tax burden. If you are caught, your tax burden can rise by as much as 80% - which is not pretty.

But, there is something you can do: you can divert all that IR35 tax money efficiently from the tax man and straight into a pension. Here's how it works...

How much extra tax is IR35?

Paying taxes under IR35 is significantly higher because full National Insurance contributions (NI) is applied for both employers NI and employees NI to all of your income. In addition you have to pay income tax (PAYE) on the whole lot.

The amount of extra tax you pay because you are caught by IR35 depends on your rate, but ranges between 30% and 80%. This is money that you've earned - it's yours, but you are forced to hand it over.

For example, a contractor on £40 an hour has an increased tax burden of 44%. For your own calculation use the [IR35 Taxes Calculator](#).

“ The great advantage of pensions for contractors caught by IR35 is the tax relief. From the start the investment has almost effectively doubled ”

ContractorCalculator.co.uk

How does investing in a pension help?

The answer is easy: Money can be contributed to a pension **before** taxes are applied.

For someone caught by IR35 earning £40 an hour each £100 drawn as gross salary (at the top end of their earnings) attracts £48 tax with only £52 ending up in their pocket.

Instead of drawing it as salary the whole £100 could be contributed to a pension. This reduces net income by £52, but increases a pension by almost double. This means contributions attract 'tax relief' of 48%.

Tax relief for some earners can be as high as 68%, due to the changes in the April 2010 Budget. In April 2010 the new additional rate of income tax of 50% was introduced for those earning over £150,000. For those contractors earning more than £150,000 per year the tax relief will be 58%. But for those earning just over £100,000 per year the effective tax rate is 60% due to the reduction in personal allowances introduced, resulting in tax relief at 68%. For high earners pensions are now an even more attractive option as a tax saving device for contractors than before.

The amount of tax relief depends on your rate. You can calculate your own using the [Contractor Pension Calculator](#).

How do pensions work?

Everything has changed for pensions funding since the so-called 'A Day' in April 2006 when the regime was vastly liberalised.

You can invest almost as much as you like, providing of course that you've earned it. The only limits that apply are a maximum of £50,000 per year, and a lifetime allowance of £1.8 million - these limits rise each year.

Some more facts about pensions:

1. Pensions aren't all about saving money to buy an annuity. You can withdraw 25% of your pension funds tax-free from age 55. And rather than buying an annuity, you can continue to draw from the funds each year to maximum limits.
2. Your savings can be passed on to your family if you die before age 75 - provided you've not bought an annuity. The money will not be subject to inheritance tax.
3. You no longer pay large portions of your payments in commissions to an IFA - charges are negligible - comparable to buying a tracker fund.
4. Your funds are perfectly safe as pensions funds cannot become insolvent. A private pension fund is carefully protected by law.
5. If you're risk adverse and concerned about funds invested in the stock market you can option for keeping the pot in cash - just like an ISA.

The great advantage of pensions for contractors caught by IR35 is the tax relief. From the start the investment has almost effectively doubled.

How Can I Get A Pension?

You could start by talking to [ContractorFinancials](#) who are specialists in the field of looking after contractors.

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